



A Better Alternative Trading System

June 27, 2006

Robert L.D. Colby  
Acting Director  
Division of Market Regulation  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549

Re: BATS ECN

Dear Mr. Colby:

BATS Trading, Inc. ("BATS") is registered with the Securities and Exchange Commission (the "Commission") as a broker-dealer and is currently a member of the National Association of Securities Dealers, Inc. ("NASD") and the National Stock Exchange ("NSX"). BATS operates as an alternative trading system pursuant to Regulation ATS of the Securities Exchange Act of 1934, as amended ("Exchange Act"), and owns and operates the electronic communications network ("ECN") known as the BATS ECN (the "System"). The Division of Market Regulation (the "Division") already has taken two separate temporary no-action positions with respect to BATS and the System. BATS respectfully requests that the Division extend its current no-action position regarding BATS' activities.

Pursuant to the Commission's letter originally granting no-action relief, dated February 17, 2006 (the "Original No-Action Letter") and the Commission's letter reaffirming this no-action relief, dated May 8, 2006 (the "Second No-Action Letter"), BATS is currently recognized as an ECN with respect to its connections to the Nasdaq Market Center and the NSX.

In connection with the additional facts set forth in this letter, BATS respectfully requests that the Division advise BATS that:

1. The System is an ECN as that term is defined in Rule 600(b)(23) of Regulation NMS of the Exchange Act;
2. BATS would be in compliance with the requirements applicable to the "ECN Display Alternative" as described in paragraph (b)(5)(ii) of Rule 602 of Regulation NMS ("Quote Rule") with respect to NMS stocks<sup>1</sup> for which a linkage between the System and a self-regulatory organization ("SRO") is operational; and

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<sup>1</sup> 17 CFR 242.600(b)(47).

3. Upon compliance by BATS with the ECN Display Alternative, the Division would not recommend that the Commission take enforcement action against OTC market makers<sup>2</sup> or exchange market makers<sup>3</sup>, as those terms are defined in Rule 600 of Regulation NMS, who are subscribers to the System if such market makers enter orders into the System without modifying their public quotations in compliance with the Quote Rule and Rule 604 of Regulation NMS (“Limit Order Display Rule”), as applicable.

### **Description of the System**

The BATS letter requesting no-action relief from the Commission, dated February 15, 2006 (the “Original Request Letter”), describes: background information regarding BATS and the System, subscriber access to the System, connections of the System to the Nasdaq Market Center, the functionality of the System’s matching engine and trade reporting, clearance and settlement. In a second letter from BATS requesting no-action relief from the Commission, dated May 4, 2006 (the “Second Request Letter”), BATS requested that the Commission extend the no-action relief to include its connection to the NSX.

The facts set forth in the Original Request Letter and the Second Request Letter have not changed. The System currently provides subscribers with automatic execution, clearance and settlement of trades in exchange-traded securities and Nasdaq securities via BATS’ computerized, proprietary trading system. Broker-dealers registered with the Commission are permitted to become subscribers. The System provides the opportunity for all subscribers to obtain execution of their orders. All subscribers’ orders displayed over the System are available for execution in whole or, where permitted by the terms of the order, in part. Direct subscriber access to the System is available at a dedicated IP address configured by BATS that assures that only authorized subscribers gain access to the System.

The System currently permits subscribers to enter buy and sell orders in exchange-traded securities and Nasdaq securities on an anonymous basis as described below.

Orders entered into the System must be priced and must have a designated size (“limit orders”) or must be “market orders”, which are defined and treated by BATS as immediate-or-cancel (“IOC”) buy orders priced five cents above the national best offer or IOC sell orders priced five cents below the national best bid at the time the order is received by BATS. Indications of interest may not be entered into the System. Unless entered with a limitation on display, the unexecuted portion of limit orders are available for display to all subscribers.

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<sup>2</sup> 17 CFR 242.600(b)(52)

<sup>3</sup> 17 CFR 242.600(b)(24). The term “exchange market maker” is defined to include “any member of a national securities exchange that is registered as a specialist or market maker pursuant to the rules of such exchange.”

## Request for No-Action Letter

In connection with its request for no-action relief, BATS makes the following representations:

1. The System is an ECN within the meaning of Rule 600(b)(23) of Regulation NMS

Rule 600(b)(23) of Regulation NMS defines an ECN as “any electronic system that widely disseminates to third parties orders entered therein by an exchange market maker or OTC market maker, and permits such orders to be executed against in whole or in part.”

The System allows subscribers, including OTC market makers and exchange market makers, electronically to enter orders in certain NMS stocks for dissemination to other subscribers, who can then effect executions, in whole or in part, against those orders. Accordingly, the System satisfies the definition of an ECN.

2. Compliance with the ECN Display Alternative

BATS has established, and will maintain, an automated linkage with at least one SRO trading facility<sup>4</sup> or SRO display-only facility<sup>5</sup>. All subscriber orders at the top of the BATS order book (i.e., best bid/ask by time priority) are transmitted to at least one SRO trading facility or SRO display-only facility for display. More specifically, BATS transmits to one or more facilities for public display by the facility or facilities the best priced orders of all orders entered by subscribers to the System, including OTC market makers or exchange market makers for securities in which they make markets or act as specialist.

Throughout the day, BATS personnel continuously and systematically monitor the System’s connection to each SRO trading facility and/or SRO display-only facility to which it links in order to ensure that the applicable connection is functioning. BATS personnel also continuously and systematically monitor the speed of the System’s connection to any SRO trading facility and/or SRO display-only facility. If a connection is not responding in a timely fashion, BATS personnel receive warning messages alerting them of the interruption and immediately investigate the interruption. If the System loses connectivity with any SRO trading facility or SRO display-only facility, BATS personnel will immediately cancel all quotes previously published by the System in that facility. In addition, BATS personnel will immediately notify all subscribers to advise them of the interruption.

3. Access

BATS will provide to any broker or dealer access to the System’s top of book quotes<sup>6</sup> that is functionally equivalent to the access that is generally available to quotes displayed by

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<sup>4</sup> 17 CFR 242.600(b)(72)

<sup>5</sup> 17 CFR 242.600(b)(71).

<sup>6</sup> As noted above, all subscriber orders at the top of the BATS order book (i.e., best bid/ask by time priority) are transmitted to at least one SRO trading facility or SRO display-only facility for display

an SRO trading facility, or, for orders displayed by an SRO display-only facility, a level and cost of access to such quotations that is substantially similar to the level and cost of access to quotations displayed by SRO trading facilities in that stock.<sup>7</sup> Non-subscribers are able to automatically execute against the quotations displayed by the System in any SRO trading facility and/or SRO display-only facility.<sup>8</sup> Upon receipt, BATS responds and intends to continue to respond to non-subscriber orders no slower than it responds to subscriber orders. Accordingly, BATS' response time to subscriber orders and non-subscriber orders is nearly equal and normally occurs within less than a second of receipt. BATS charges non-subscriber broker-dealers a rate that does not exceed the then current rate charged to a substantial portion of its active broker-dealer subscribers and in any event not in excess of the maximum fee as authorized by Rule 610 of Regulation NMS.<sup>9</sup>

#### 4. Capacity and Security

BATS further represents that the System has sufficient capacity to handle the volume of trading reasonably projected to be conducted in the System. Moreover, BATS conducts and will continue to conduct regular and periodic system capacity reviews and tests to: (i) ensure future capacity; (ii) identify potential weaknesses; and (iii) reduce the risks of system failures and threats to system integrity.

BATS has and will maintain procedures to ensure that only certain designated personnel have access to the System. Those designated personnel will keep all trading information entered into the System confidential and will not use such information for trading in BATS' or any affiliate's proprietary account, its customers' accounts, or their own personal trading accounts. For example, firewalls are implemented at the network level on the processing system, allowing only authorized personnel to access the System. Key cards are necessary to physically access BATS facilities and all computer systems are password protected. Access to information about the trading

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<sup>7</sup> Were BATS to establish a linkage with an SRO display-only facility, BATS would contract with a reputable party engaged in the securities industry that would be able to provide order delivery services on behalf of the System. Such a relationship would be established in order to provide meaningful access to BATS' quotations.

<sup>8</sup> Non-subscribers may access quotes published by BATS in various ways. For instance, a broker-dealer member of an SRO trading facility that is not a subscriber to BATS, but that seeks to access a quote published by BATS in such SRO trading facility, could send a message through the SRO trading facility's automated systems to execute against BATS' published quote. Alternatively, a non-subscriber that has established a connection to another ECN or market participant could access BATS' published quote indirectly through such ECN or market participant if such ECN or market participant has a connection to the SRO trading facility where BATS publishes its quotes. Finally, it is possible for a non-subscriber to send its order to a broker-dealer that is a subscriber to the System, and such subscriber may route the order directly to BATS.

<sup>9</sup> Rule 610(c) of Regulation NMS generally limits the fee that market participants, including ECNs, may in the aggregate charge for accessing a protected quotation to no more than \$ 0.003 per share. Rule 610(c) became effective as of August 29, 2005, but is subject to delayed compliance dates and thus, is not yet applicable to BATS. See Securities Exchange Act Release 51808 (June 9, 2005), 70 FR 37496, 37576 (June 29, 2005).

activity of subscribers is limited to a need-to-know basis for all employees, officers and directors of BATS. Furthermore, the operation of the System will be kept separate from other business activities of BATS.<sup>10</sup>

For contingency purposes, each service is duplicated at the hardware, network and software levels. BATS has redundant network connections from its core system into the SAVVIS network. The SAVVIS network utilizes redundant backbone segments and redundant edge devices. The matching engine architecture at BATS allows for trade activity load balancing across multiple instances. In this way, the operations team at BATS can move a group of securities traded on one matching unit (should it fail or realize degradation in performance) to one or more alternate matching units. In addition, BATS has redundant access to any SRO trading facility or SRO display-only facility to which it connects for trade reporting as well as for the execution of orders (including both outbound and inbound orders). This redundant infrastructure significantly reduces the risk that the System will lose connectivity to a trading facility.

### Conclusion

On the basis of the foregoing, we respectfully request that the Division advise BATS that:

1. The System is an ECN as that term is defined in Rule 600(b)(23) of Regulation NMS;
2. BATS would be in compliance with the requirements applicable to the ECN Display Alternative with respect to NMS stocks for which a linkage between the System and an SRO is operational; and
3. Upon compliance by BATS with the ECN Display Alternative, the Division would not recommend that the Commission take enforcement action against OTC market makers or exchange market makers (including exchange specialists) who are subscribers to the System if such market makers enter orders into the System without modifying their public quotations in compliance with the Quote Rule and the Limit Order Display Rule.

If you have any questions or seek any additional information regarding this matter, please contact the undersigned at (816) 285-9900

Sincerely,



David Cummings  
Chief Executive Officer  
BATS Trading, Inc.

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<sup>10</sup> BATS currently has one business line, the operation of the System, and thus has no separate business activities. If, in the future, BATS develops other business lines, it will keep the operation of the System separate from such other business lines